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IN THE

Supreme Court of the United States

October Term, 1967

No. 265

CHARLES TOWN, INCORPORATED,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY TO MEMORANDUM FOR THE RESPONDENT IN OPPOSITION.

It is noteworthy that while respondent, in his Memorandum in Opposition, uses four numbered points to respond to petitioner's four numbered reasons for granting the writ, he changes the order and wholly omits any response whatever to petitioner's Reason 3. Even as to the other three reasons given by petitioner respondent's memorandum is not actually a response; it is a confession. As it will be seen, his contentions are in conflict with his own authorities.

We shall take respondent's four points in their order.

1. In order to connect Fairmount's advances to petitioner with a sum Fairmount had previously received from Housing, respondent persists in trying to add the advances for the two racing meets together (Mem. 3), despite the simple arithmetic showing that Fairmount's advances for the first racing meet were

repaid in full before any step looking toward a second meet was taken. (Pet. 6, fn. 4.) We consider this effort of respondent's irrelevant, however, because the issue of allocation here is not between Housing and Fairmount, but between Fairmount and petitioner. If respondent desired to contend that the income received by Fairmount belonged to Housing, that would be another case. Surely the furnishing of half a million dollars for each meet, whether the source was Fairmount or Housing, was no "mere paper connection," as respondent attempts to say (Mem. 3).

2. Respondent implies (Mem. 4-5) that Congress gave him the power to determine, without limitation, whether common control existed in a particular situation. The broad authority given respondent under Section 482 of I.R.C. 1954 is to allocate "In any case" where common control exists; the broad authority given him there does not include determination as to *whether* such control exists. In none of the cases which respondent cites, moreover, was the issue of common control presented.

In the two tax cases cited by respondent, *Spicer Theatre, Inc. v. Commissioner*, 346 F.2d 704 (C.A. 6), and *National Securities Corporation v. Commissioner*, 137 F.2d 600 (C.A. 3), the only power granted by Congress considered was the power to make the required allocation. In each the common control was based upon ownership; in *Spicer* all the common stock of both corporations was owned by an individual and his wife, and in *National Securities Corporation* the two corporations involved were parent and wholly owned subsidiary. In the non-tax cases cited by respondent there is the same effect. In *American Power and*

Light Co. v. Securities and Exchange Commission, 329 U.S. 90, involving the Public Utility Holding Company Act, the two entities involved were two subholding companies in a single holding company system; the power granted by Congress at issue was only the power to determine whether the system structure was unduly complicated, or unfairly distributed voting power. And in *Hampton & Co. v. United States*, 276 U.S. 394, there was but one entity; the determination to be made was the tariff necessary to equalize the domestic and foreign cost of a particular, specified product, barium dioxide.

In *American Power and Light Co.*, moreover, it was held that, as quoted by respondent himself (Mem. 5), Congress cannot delegate authority without stating the *boundaries* of the delegated authority. Of course, every person who furnishes the money for a venture is able to demand and exercise a large measure of control in respect to it. Indeed, many banks, solely because of their money, are able to exercise strong control over their borrowers.

Here, if respondent really had been given by Congress the broad power to determine whether in any given situation common control existed, what were the boundaries of that power, as stated by Congress? There were no such boundaries stated. On that basis alone, the provision, as respondent here would interpret and apply it, would be invalid.

3. Respondent in attempting (Mem. 5) to distinguish *Rooney v. United States*, 305 F. 2d 681 (C.A. 9), in effect admits that he cannot distinguish it. He says there that the Cohens controlled, among other things, "the execution of the agreement between Fairmount and

Charles Town assuring essential capital for the new corporation and their continued control of the business venture."

Of course, the agreement assured no such continuing control since by its express terms, repeated again and again, it applied only to *the* racing meet (Pet. App. 30-32; pars. 1, 2, 3, 5, 8, 10), a meet to run for a period of less than four months, precisely described, by beginning and ending dates, at the very outset of the agreement (Pet. App. 30, par. 1). And respondent's reference to the agreement, especially to the fact that it *assured* the essential capital, shows his reliance upon the agreement as the basis of control.

Now that agreement came into legal existence when petitioner, at its organization meeting, and after Pondfield had subscribed to 98 per cent of its stock (Pet. App. 81), ordered the execution of the agreement (Pet. App. 83). That meeting, at the time of such order, was thus under the control of Pondfield as the subscriber for the majority of the shares subscribed for. Fletcher Cyclopedia Corporations, Ch. 44, §3756, at fn. 15, Ch. 13, §2027, at fns. 11, 12.[1] Clearly Pondfield was in control of petitioner at the critical point at which that corporation became legally a party to the agreement. Clearly then the decision below is in direct conflict with the Ninth Circuit in *Rooney, supra.*

4. In his attempt to distinguish *Davis v. United States,* 282 F. 2d 623 (C.A. 10), respondent (Mem. 6) volunteers the idea that the transactions involved bear no resemblance to an arm's length agreement.

[1]Neither the West Virginia Code nor the corporate charter of Charles Town, Joint Exhibit 47-AU, Pet. App. 81-83, summarized at Pet. App. 24, contains anything to the contrary.

There is no finding, nor any evidence, to support this, and respondent points to none. Respondent then says that the Tax Court found that the amounts advanced by Fairmount were in the nature of an equity investment. They were an equity investment, indeed, but in a venture, precisely described and to be carried out during a very short and specifically stated calendar period. First there was one such venture, and subsequently, under a completely new and separate agreement, a second, and then no more. For that very reason there could be no finding, and there is none, that the amounts advanced by Fairmount were an equity investment in petitioner, *Charles Town, the corporation.*

Moreover, under each of the two agreements Fairmount undertook the burden of furnishing "all monies necessary" for the operation of the meet, and of bearing entirely any loss. Respondent emphasizes the first of these burdens by referring to the agreement's "assuring" the essential capital (Mem. 5). Because of these burdens Fairmount clearly could not assign its interest under either agreement, as it could stock. 6 CJS 1073-4 (Assignments §25).

Respondent correctly states here, furthermore, that an investor cannot agree to divide taxable income with the corporation. This in itself is an admission that Fairmount was not an investor in Charles Town, the corporation, but only in the venture for which the agreement between them provided.

Nor can respondent, as he does here, rely upon the agreement and attack it at the same time. Respondent relies, as he must, upon the agreement to show control. He wholly fails to show that without the agreement in each case the Cohens would have had any

control over the racing meet involved. He is in no position therefore to challenge its division of income. 17A CJS Contracts, §297, giving several pages of supporting citations, including *Wood Coal Co. v. Little Beaver Mining Corp.*, 116 S.E. 2d 394, 397, 145 W. Va. 653, and *Miller v. Robertson*, 266 U.S. 243, 251. Respondent's attempt to distinguish *Davis* has no validity whatever. Clearly the decision below is in direct conflict with the Tenth Circuit in the *Davis* case.

Conclusion.

Finally, we point out again that respondent makes no attempt whatever to respond to our Reason 3 (Pet. 10-12).

We submit in conclusion that the petition for a writ of certiorari should be granted.

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